



TOUCHMARK
B A N C S H A R E S , I N C.

2016

Annual Report to Shareholders



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April 2017

Dear Shareholder:

2016 marks a major milestone in the history of Touchmark National Bank and Touchmark Bancshares, Inc. The Bank became cumulatively profitable at year end and the Company paid its first ever dividend. Our achievements were realized after many years of persistent work, sound growth and strong financial performance. We are extremely proud of these accomplishments and are grateful to everyone for their support in helping us get there.

Our Bank's assets increased nearly \$82 million (42%) to \$277 million from the previous year. Total loans increased over \$69 million (44%) to \$225 million after sales of Government Guaranteed loans of \$30 million. In spite of the excellent loan growth, there were no loan losses in 2016. Total deposits increased by \$81 million (57%) to \$224 million, including brokered deposits of \$16 million which were necessary to fund the loan growth. Credit quality remained the focal point of our growth as evidenced by only one classified loan and no other identifiable problem assets. The Bank remains 5-Star rated by Bauer Financial, an honor earned in September 2015. Capital is strong and is expected to support the anticipated needs for the coming year.

Enclosed you will find the Company's 2016 audited financial statements. Net income before taxes (NIBT) reached \$3.8 million; an increase of 41% from the \$2.7 million generated in 2015. As a result of the substantial loan growth experienced during 2016, provisions to the loan loss reserve amounted to \$800 thousand as compared to \$625 thousand in 2015. Net income after taxes (NIAT) of \$2.4 million represents a 37% increase from the \$1.8 million recorded in prior year which translate into earnings per share (EPS) of \$0.71 and \$0.51, respectively. Net interest income increased by 32% to \$8.5 million resulting in an overall net interest margin of 3.87%. This represents an increase of 10 basis points from the prior year from improved loan yields and investments. Gains on the sale of Government Guaranteed loans increased by nearly \$1 million dollars over the prior year to \$3 million.

Much of our Company's performance in 2016 stems in part from strategic efforts undertaken over the last few years. While these initiatives took time to materialize, the results of our efforts did come to fruition and produced the desired results which led our Board of Directors to declare a dividend for the first time in the Company's history. A regular dividend of \$0.10 per share and a one-time special dividend of \$0.05 per share were declared and paid on January 31, 2017.

Over the next few years, we will concentrate on safe and sound asset growth. Being in a growth mode may likely impact earnings in the short-term which is a common attribute of growing companies. This growth initiative, in combination with a rising rate environment, an upward trending economy and a stable banking climate should complement the intended results and long term goal of maximizing shareholder value.

On behalf of the Board of Directors and management, we would like to personally thank you for all your support throughout the years.

Very truly yours,

J.J. Shah, MD
Chairman, Board of Directors

Jorge L. Forment
President & CEO

TOUCHMARK BANCSHARES, INC. AND SUBSIDIARY

Consolidated Financial Statements

December 31, 2016 and 2015
(with Independent Auditor's Report thereon)



INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Shareholders
Touchmark Bancshares, Inc. and subsidiary
Alpharetta, Georgia

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Touchmark Bancshares, Inc. and subsidiary, which comprise the balance sheets as of December 31, 2016 and 2015, and the related statements of earnings, comprehensive income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Touchmark Bancshares, Inc. and subsidiary as of December 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Porter Keadle Moore, LLC

Atlanta, Georgia
March 24, 2017

TOUCHMARK BANCSHARES, INC. AND SUBSIDIARY

Consolidated Balance Sheets

December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
ASSETS		
Cash and due from banks	\$ 9,731,640	2,299,497
Federal funds sold	10,750,000	-
Cash and cash equivalents	20,481,640	2,299,497
Interest-bearing accounts with other banks	2,473,233	2,836,603
Securities available-for-sale	24,691,582	28,479,841
Restricted stock	1,959,750	1,968,300
Loans, net	222,262,760	153,791,891
Premises and equipment, net	1,560,265	1,510,988
Foreclosed real estate	-	525,000
Land held for sale	-	1,650,000
Other assets	3,564,735	3,894,399
Total assets	<u>\$ 276,993,965</u>	<u>196,956,519</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Non-interest bearing demand	\$ 27,678,718	12,898,398
Interest bearing	193,260,824	129,046,218
Total deposits	220,939,542	141,944,616
Federal funds purchased	-	408,000
Federal Home Loan Bank advances	19,750,000	21,750,000
Other liabilities	2,261,368	552,446
Total liabilities	<u>242,950,910</u>	<u>164,655,062</u>
Commitments		
Stockholders' equity:		
Preferred stock, no par value, 10,000,000 shares authorized, none issued	-	-
Common stock, \$.01 par value 50,000,000 shares authorized, 3,465,391 issued and outstanding	34,654	34,654
Paid-in capital	36,260,695	36,260,695
Accumulated deficit	(2,055,331)	(3,984,427)
Accumulated other comprehensive loss	(196,963)	(9,465)
Total stockholders' equity	<u>34,043,055</u>	<u>32,301,457</u>
Total liabilities and stockholders' equity	<u>\$ 276,993,965</u>	<u>196,956,519</u>

See accompanying notes to the consolidated financial statements

TOUCHMARK BANCSHARES, INC. AND SUBSIDIARY

Consolidated Statements of Earnings

December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Interest income:		
Loans, including fees	\$ 9,613,962	7,038,786
Investment income	523,734	635,527
Federal funds sold	22,158	7,596
Other	<u>116,107</u>	<u>77,217</u>
Total interest income	<u>10,275,961</u>	<u>7,759,126</u>
Interest expense:		
Deposits	1,519,087	1,081,246
Federal Home Loan Bank advances	277,924	239,836
Other borrowings	<u>745</u>	<u>5,860</u>
Total interest expense	<u>1,797,756</u>	<u>1,326,942</u>
Net interest income	8,478,205	6,432,184
Provision for loan losses	<u>800,000</u>	<u>625,000</u>
Net interest income after provision for loan losses	<u>7,678,205</u>	<u>5,807,184</u>
Noninterest income:		
Service charges on deposit accounts and other fees	43,212	61,685
Gain on sale of securities available-for-sale	145,164	102,604
Gain on sale of government guaranteed loans	3,074,986	2,093,330
Gain on sale of foreclosed real estate	21,360	-
Gain on disposition of land held-for-sale	223,762	-
Other noninterest income	<u>523,195</u>	<u>638,725</u>
Total noninterest income	<u>4,031,679</u>	<u>2,896,344</u>
Noninterest expense:		
Salaries and employee benefits	4,179,425	3,375,237
Occupancy and equipment	330,029	354,543
Write-down of restricted stock	-	10,000
Write-down of land held for sale	8,517	250,000
Write-down and other expenses related to other real estate	9,074	158,149
Other operating expense	<u>3,344,934</u>	<u>1,834,157</u>
Total noninterest expense	<u>7,871,979</u>	<u>5,982,086</u>
Income before taxes	3,837,905	2,721,442
Income tax expense	<u>1,389,000</u>	<u>936,936</u>
Net earnings	<u>\$ 2,448,905</u>	<u>1,784,506</u>

See accompanying notes to the consolidated financial statements.

TOUCHMARK BANCSHARES, INC. AND SUBSIDIARY
Consolidated Statements of Comprehensive Income
December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Net earnings	\$ <u>2,448,905</u>	<u>1,784,506</u>
Other comprehensive loss:		
Unrealized losses on investment securities available-for-sale:		
Holding losses arising during the period, net of taxes of \$44,446 and \$13,618	(90,238)	(27,650)
Reclassification adjustment for gains included in net earnings, net of taxes of \$47,904 and \$33,859	<u>(97,260)</u>	<u>(68,745)</u>
Total other comprehensive loss	<u>(187,498)</u>	<u>(96,395)</u>
Comprehensive income	<u>\$ <u>2,261,407</u></u>	<u><u>1,688,111</u></u>

See accompanying notes to the consolidated financial statements.

TOUCHMARK BANCSHARES, INC. AND SUBSIDIARY
Consolidated Statements of Changes in Stockholders' Equity
For the Years Ended December 31, 2016 and 2015

	Outstanding Shares of Common Stock	Common Stock	Additional Paid-in Capital	(Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance, December 31, 2014	3,465,391	\$ 34,654	36,258,446	(5,768,933)	86,930	30,611,097
Stock-based compensation expense	-	-	2,249	-	-	2,249
Net earnings	-	-	-	1,784,506	-	1,784,506
Change in unrealized gain/loss on securities available-for-sale	-	-	-	-	(96,395)	(96,395)
Balance, December 31, 2015	3,465,391	34,654	36,260,695	(3,984,427)	(9,465)	32,301,457
Dividend declared on common shares (\$.15 per share)	-	-	-	(519,809)	-	(519,809)
Net earnings	-	-	-	2,448,905	-	2,448,905
Change in unrealized gain/loss on securities available-for-sale	-	-	-	-	(187,498)	(187,498)
Balance, December 31, 2016	<u>3,465,391</u>	<u>\$ 34,654</u>	<u>36,260,695</u>	<u>(2,055,331)</u>	<u>(196,963)</u>	<u>34,043,055</u>

See accompanying notes to the consolidated financial statements.

TOUCHMARK BANCSHARES, INC. AND SUBSIDIARY
Consolidated Statements of Cash Flows
For the Years Ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities:		
Net earnings	\$ 2,448,905	1,784,506
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation, amortization and accretion	262,604	420,345
Provision for loan losses	800,000	625,000
Deferred income taxes	1,211,011	936,936
(Gain) on sales and write-down of foreclosed real estate, net	(21,360)	140,000
Stock-based compensation expense	-	2,249
Gain on sales of securities available-for-sale	(145,164)	(102,604)
Gain on sales of government guaranteed loans	(3,074,986)	(2,093,330)
Write-down of restricted stock	-	10,000
(Gain) on sale and write-down of land held-for-sale	(61,931)	250,000
Change in:		
Other assets	(788,996)	(639,948)
Other liabilities	1,189,113	176,955
Net cash provided by operating activities	<u>1,819,196</u>	<u>1,510,109</u>
Cash flows from investing activities:		
Decrease in interest bearing accounts at other banks	363,370	906,757
Proceeds from paydowns, calls and maturities of securities available-for-sale	3,763,155	4,054,432
Proceeds from sales of securities available-for-sale	12,114,797	6,442,409
Purchases of securities available-for-sale	(12,369,503)	(9,093,808)
Proceeds from sale of restricted stock	212,500	-
Purchase of restricted stock	(203,950)	(593,350)
Proceeds from sale of foreclosed real estate	546,360	-
Proceeds from sales of land held-for-sale	1,711,931	-
Purchase of loans	-	(9,835,597)
Increase in loans, net	(66,230,522)	(25,789,500)
Purchases of premises and equipment	(132,117)	(36,919)
Net cash used in investing activities	<u>(60,223,979)</u>	<u>(33,945,576)</u>
Cash flows from financing activities:		
Change in deposits	78,994,926	19,190,675
Decrease in federal funds purchased, net	(408,000)	(353,000)
Proceeds from Federal Home Loan Bank advances	10,000,000	15,000,000
Repayment of Federal Home Loan Bank advances	(12,000,000)	(1,000,000)
Net cash provided by financing activities	<u>76,586,926</u>	<u>32,837,675</u>
Net change in cash and cash equivalents	18,182,143	402,208
Cash and cash equivalents at beginning of the year	<u>2,299,497</u>	<u>1,897,289</u>
Cash and cash equivalents at end of the year	<u>\$ 20,481,640</u>	<u>2,299,497</u>
Supplemental schedule of non-cash investing and financing activities:		
Change in unrealized gain/loss on securities available-for-sale, net of tax	\$ (187,498)	(96,395)
Cash paid during the year for interest	\$ 1,303,621	1,322,725
Change in dividends payable	\$ 519,809	-

See accompanying notes to consolidated financial statements.

(1) Summary of Significant Accounting Policies

The accounting and reporting policies of Touchmark Bancshares, Inc. conform to generally accepted accounting principles and with general practices within the banking industry. The following is a description of the more significant of those policies that the Company follows in preparing and presenting its financial statements.

Reporting Entity and Nature of Operations

Touchmark Bancshares, Inc. (the "Company"), a Georgia corporation, was established on April 3, 2007 for the purpose of organizing and managing Touchmark National Bank (the "Bank"). The Company is a one-bank holding company with respect to its subsidiary, Touchmark National Bank. The Bank was opened with the purpose of serving as a community bank. The Bank's primary service area includes the counties of North Fulton, Gwinnett, DeKalb, Cobb and Forsyth. On May 10, 2016, the Company was granted approval from the Federal Reserve Bank to become a financial holding company.

The Bank operates from its headquarters in Alpharetta, Georgia and also leases office space nearby for its lending group. The Company's primary sources of revenue are derived from the Bank's loans to customers within its geographical area and its investment portfolio. The Company's earnings are primarily dependent upon its net interest income, which is determined by (i) the difference between yields earned on interest-earning assets and rates paid on interest-bearing liabilities ("interest rate spread") and (ii) the relative amounts of interest-earning assets and interest-bearing liabilities outstanding. The Company's interest rate spread is affected by regulatory, economic, and competitive factors that influence interest rates, loan demand and deposit flows. The Company, like other community banks, is vulnerable to an increase in interest rates to the extent that interest-bearing liabilities mature or re-price more rapidly than interest-earning assets.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiary. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for losses on loans, the valuation of real estate acquired in connection with foreclosure or in satisfaction of loans, fair market value of securities, derivatives and financial instruments, the valuation of deferred tax assets, and the disclosure of contingent assets and liabilities. In connection with the determination of the allowances for losses on loans, management obtains independent appraisals for significant properties.

Management believes the allowance for losses on loans is adequate. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in local economic conditions.

Subsequent Events

Management has evaluated subsequent events for potential recognition or disclosure in the financial statements through March 24, 2017, the date on which the financial statements were available to be issued.

(1) **Summary of Significant Accounting Policies, continued**

Cash and Cash Equivalents

Cash and cash equivalents include cash, due from banks and federal funds. Cash flows from deposits, federal funds sold, secured borrowings, and originations and collections of loans are reported net. The Bank is required to maintain reserve balances in cash or on deposit with the Federal Reserve Bank based on a percentage of deposits. The required reserve balance at December 31, 2016 and 2015 was \$202,000 and \$75,000, respectively.

Investment Securities

Securities, including equity securities with readily determinable fair values, are classified as securities available-for-sale and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income (loss).

Purchase premiums and discounts are recognized in interest income using methods approximating the interest method over the terms of the securities. A decline in the market value of any security below cost that is deemed other than temporary results in a charge to earnings and the establishment of a new cost basis for the security. The general standards of accounting for other than temporary impairment (OTTI) losses require the recognition of an OTTI loss in earnings only when an entity (1) intends to sell the debt security; (2) more likely than not will be required to sell the security before recovery of its amortized cost basis or (3) does not expect to recover the entire amortized cost basis of the security. Realized gains and losses for securities are included in earnings and are derived using the specific identification method for determining the amortized cost of securities sold as of the trade date.

Periodically, all available-for-sale securities are evaluated for other-than-temporary impairment (OTTI) in accordance with U.S. generally accepted accounting principles, which specifies requirements for recognizing OTTI on debt securities, presentation of OTTI losses, and modifies and expands disclosure about OTTI for debt securities.

A debt security is considered to be other-than-temporarily impaired if the present value of cash flows expected to be collected are less than the security's amortized cost basis (the difference defined as the credit loss) or if the fair value of the security is less than the security's amortized cost basis and the investor intends, or more likely than not will be required, to sell the security before recovery of the security's amortized cost basis, the charge to earnings is limited to the amount of the credit loss. Any remaining difference between fair value and amortized cost (the difference defined as the non-credit portion) is recognized in other comprehensive income. Otherwise, the entire difference between fair value and amortized cost basis is charged to earnings.

Restricted Stock

Restricted stock consists of Federal Reserve Bank and Federal Home Loan Bank of Atlanta (FHLB) stock which represents an equity interest in these entities and is recorded at cost. These stocks do not have a readily determinable fair value because ownership is restricted and lacks a market.

The company also had an investment in the Independent Bankers Bank of Florida. During 2015, the Company evaluated the underlying financial condition of the Independent Bankers Bank of Florida and determined that their restricted stock investment was other-than-temporarily impaired, and recorded a charge to income of \$10,000, resulting in no remaining carrying balance for the investment. Management also evaluated its holdings in FHLB and Federal Reserve Bank stock and determined par value is ultimately recoverable and therefore determined that FHLB and Federal Reserve Bank stock was not other-than-temporarily impaired. In addition, the Bank has ample liquidity and does not require redemption of its restricted stock holdings in the foreseeable future.

(1) **Summary of Significant Accounting Policies, continued**
Loans Receivable

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal, adjusted for any charge-offs, the allowance for loan losses, deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans.

Interest on loans is credited to income on a daily basis based upon the principal amount outstanding. Loan origination fees and certain direct origination costs, less the costs associated with closing the loan, are capitalized and recognized as an adjustment of the yield of the related loan. The related loan origination costs are recognized as an expense at the time the loan is originated. The net effect on the financial condition and results of operations of not deferring the net fees and costs is not significant.

The accrual of interest on loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed, unless management believes that the accrued interest is recoverable through the liquidation of collateral. Interest income is subsequently recognized only to the extent cash payments are received. Loans are returned to accrual status when all the principal and interest amounts contractually due are reasonably assured of repayment within a reasonable time frame.

Loan delinquencies are determined by comparing contractual requirements to the timing of payments received from the borrower. The policies and procedures related to nonaccrual and delinquent loans are applied to all outstanding loans.

Allowance for Loan Losses

The allowance for loan losses is increased by provision charges to income and decreased by charge-offs (net of recoveries). Loans are charged against the allowance for loan losses when management believes the collection of the principal is unlikely. The allowance for loan losses is maintained at a level believed adequate by management to absorb estimated probable inherent loan losses and estimated losses relating to specifically identified loans. Management's periodic evaluation of the adequacy of the allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay (including the timing of payments), the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions, and other relevant factors. This evaluation is inherently subjective as it requires material estimates that are susceptible to significant change including the amounts and timing of future cash flows expected to be received on impaired loans.

While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for losses on loans. Such agencies may require the Company to recognize additions to the allowance based on their judgment about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the allowance for losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

The allowance for loan losses may consist of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the collateral value less selling costs, present value of expected cash flows, or the observable market price of the impaired loan is lower than the carrying value of the loan.

(1) Summary of Significant Accounting Policies, continued
Allowance for Loan Losses, continued

A loan is considered impaired when, based on current information and events, it is probable the Company will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Impaired loans are measured by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the estimated fair value of the collateral, less selling costs, if the loan is collateral dependent. The amount of impairment, if any, and any subsequent changes are included in the allowance for loan losses or charged-off if determined to be uncollectible. By the time a loan becomes probable for foreclosure it has been charged down to fair value, less estimated costs to sell.

General allowances are established for non-impaired loans. These loans are assigned a loan category, and the allocated allowance for loan losses is determined based upon the loss percentage factors that correspond to each loan category.

Loss percentage factors are based on historical loss experience adjusted for qualitative factors. The qualitative factors consider among other things, credit concentrations, recent levels and trends in delinquencies and nonaccrual loans, and growth in the loan portfolio. The occurrence of certain events could result in changes to the loss factors. Accordingly, these loss factors are reviewed periodically and modified as necessary.

The general reserves are determined based on consideration of historic loss data, the various risk characteristics of each loan segment, and whether the loans are within or outside the Company's general market area. Risk characteristics relevant to each portfolio segment are as follows:

Construction and development loans — Loans in this segment primarily include real estate development loans for which payment is derived from sale of the property as well as construction projects in which the property will ultimately be used by the borrower. Credit risk is affected by cost overruns, time to sell at an adequate price, and market conditions.

Real estate - mortgage — Loans in this segment are dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates, will have an effect on the credit quality in the segment. The Company generally does not originate loans with a loan-to-value ratio greater than 85% and does not grant subprime loans.

Commercial real estate — Loans in this segment are owner occupied business properties and non-owner occupied business income-producing properties. The underlying cash flows generated by the properties and the businesses occupying the properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates and decreased owner cash flows, which in turn, will have an effect on the credit quality in this segment. Management monitors the cash flows of these borrowers.

Commercial and industrial loans — Loans in this segment are made to businesses and are generally secured by assets of the business. Repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased consumer spending, will have an effect on the credit quality in this segment.

(1) **Summary of Significant Accounting Policies, continued**
Allowance for Loan Losses, continued

Other loans – Loans in the segment are made to individuals and are generally secured by personal property and/or personal guaranties. Repayment is expected from the cash flows of the individual which is affected by the overall economy with specific regards to the unemployment rate.

Unallocated allowances relate to inherent losses that are not otherwise evaluated in the specific and general allowances. The qualitative factors associated with unallocated allowances are subjective and require a high degree of management judgment. These factors include the inherent imprecision in mathematical models and credit quality statistics, recent economic uncertainty, losses incurred from recent events, lagging or incomplete data and the significant factors affecting the real estate market.

Significant Group Concentrations of Credit Risk

A substantial portion of the Company's loan portfolio is to customers in Gwinnett, Dekalb, north Fulton, and south Forsyth counties and surrounding areas in Georgia. The ultimate collectability of a substantial portion of the portfolio is therefore susceptible to changes in the economic and market condition in and around this area.

The nature of the Company's business requires that it maintain amounts due from banks, which at times may exceed federally insured limits. The Company has not experienced any losses in such accounts, and management works to mitigate risk associated with its correspondent institutions. Amounts due from banks are typically maintained in demand deposit accounts which are insured up to \$250,000.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company - put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation, computed principally on the straight- line method over the estimated useful lives of the assets.

Maintenance and repairs that do not extend the useful life of the premises and equipment are charged to expense. The useful lives of premises and equipment are as follows:

Buildings	40 years
Leasehold improvements	lesser of lease term or expected life
Furniture, fixtures and equipment	3-9 years

Foreclosed Real Estate

Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value less selling costs at the date of foreclosure establishing a new cost basis. Any write down to fair value at the time of foreclosure is charged to the allowance for loan losses. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of carrying amount or fair value less cost to sell. Costs of improvements are capitalized, whereas costs relating to holding foreclosed real estate and subsequent adjustment to the value are expensed.

TOUCHMARK BANCSHARES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements, continued

(1) Summary of Significant Accounting Policies, continued
Income Taxes

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws and considers any uncertain tax positions.

A valuation allowance for deferred tax assets is required when it is more likely than not that some portion or all of the deferred tax asset will not be realized. In assessing the realization of the deferred tax assets, management considers the scheduled reversals of deferred tax liabilities, projected future taxable income (in the near-term based on current projections), and tax planning strategies.

The Company recognizes accrued interest associated with uncertain tax positions as part of interest expense and penalties associated with uncertain tax positions as part of other expenses. As of December 31, 2016 and 2015, there were no accrued interest and penalties associated with uncertain tax positions.

The operating results of the Company and its subsidiary are included in consolidated income tax returns.

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. The Company has recorded a liability related to a pending claim as of December 31, 2016. The pending claim is described more fully in Note 10.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in our net earnings. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with our net earnings, are components of comprehensive income (loss).

Stock Based Compensation

The Company maintains a share-based employee compensation plan for grants of equity based compensation to key personnel. The Company accounts for such share-based payment based on the fair value of such as of the date of grant. Upon issuance of share based payment awards, compensation cost is recognized in the consolidated financial statements of the Company for all share-based payments granted, based on the grant date fair value over the requisite service period of the awards. The stock based compensation plan is described more fully in Note 12.

(2) Securities Available-for-Sale

Investment securities available-for-sale at December 31, 2016 and 2015 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<u>December 31, 2016:</u>				
U.S. Government sponsored enterprises	\$ 1,388,126	-	32,498	1,355,628
State and municipal securities	2,627,496	6,770	9,070	2,625,196
Mortgage-backed securities	20,969,935	24,025	283,202	20,710,758
Total	<u>\$ 24,985,557</u>	<u>30,795</u>	<u>324,770</u>	<u>24,691,582</u>
<u>December 31, 2015:</u>				
U.S. Government sponsored enterprises	\$ 3,261,737	1,435	74,642	3,188,530
State and municipal securities	3,214,670	75,755	-	3,290,425
Mortgage-backed securities	22,017,557	41,638	58,309	22,000,886
Total	<u>\$ 28,493,964</u>	<u>118,828</u>	<u>132,951</u>	<u>28,479,841</u>

TOUCHMARK BANCSHARES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements, continued

(2) Securities Available-for-Sale, continued

The following table outlines the unrealized losses and fair value by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2016 and 2015.

	2016		2015	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Unrealized loss for less than 12 months:				
U.S. Government sponsored enterprises	\$ 1,355,628	32,498	-	-
State and municipal securities	2,115,556	9,070	-	-
Mortgage backed securities	<u>14,151,601</u>	<u>283,202</u>	<u>11,317,284</u>	<u>50,541</u>
Less than 12 months	<u>17,622,785</u>	<u>324,770</u>	<u>11,317,284</u>	<u>50,541</u>
Unrealized loss for greater than 12 months:				
U.S. Government sponsored enterprises	-	-	2,571,713	74,642
State and municipal securities	-	-	-	-
Mortgage backed securities	<u>-</u>	<u>-</u>	<u>476,829</u>	<u>7,768</u>
Total more than 12 months	<u>-</u>	<u>-</u>	<u>3,048,542</u>	<u>82,410</u>
Total	<u>\$ 17,622,785</u>	<u>324,770</u>	<u>14,365,826</u>	<u>132,951</u>

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation.

At December 31, 2016, 21 of 33 debt securities have unrealized losses with aggregate depreciation of 1.3% from the Company's amortized cost basis. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and industry analysts' reports. As management has the ability to hold debt securities until maturity, or for the foreseeable future, no declines are deemed to be other than temporary.

The amortized cost and estimated fair value of securities available-for-sale at December 31, 2016, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
U.S Government sponsored enterprises & state and municipal securities:		
Five to ten years	\$ 2,627,502	2,625,201
Over ten years	1,388,120	1,355,623
Mortgage-backed securities	<u>20,969,935</u>	<u>20,710,758</u>
	<u>\$ 24,985,557</u>	<u>24,691,582</u>

The Company had gross gains on sales of securities of \$157,621 and \$126,990 for 2016 and 2015, respectively. Gross losses on sales of securities were \$12,457 and \$24,386 for 2016 and 2015, respectively.

Securities with a carrying value of \$1,826,614 and \$1,498,188 at December 31, 2016 and 2015, respectively, were pledged to secure certain deposits.

TOUCHMARK BANCSHARES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements, continued

(3) Loans and Allowance for Loan Losses

Major classifications of loans at December 31, 2016 and 2015 are summarized as follows:

	2016	2015
Construction and development	\$ 22,345,484	21,162,817
Real estate – mortgage	17,341,540	20,576,071
Commercial real estate	164,163,833	96,954,649
Commercial and industrial	19,476,536	14,810,099
Other	2,940,186	2,929,251
	226,267,579	156,432,887
Less: Allowance for loan losses	3,183,730	2,375,172
Unearned income	821,089	265,824
Loans, net	\$ 222,262,760	153,791,891

The Bank grants loans and extensions of credit to individuals and a variety of businesses operating primarily in the north-metro Atlanta area. Although the Bank has a diversified loan portfolio, a substantial portion of the portfolio is collateralized by improved and unimproved real estate and is dependent upon the real estate market.

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2016 and 2015:

December 31, 2016:	Construction and Development	Real Estate - Mortgage	Commercial Real Estate	Commercial and Industrial	Other	Unallocated	Total
Allowance for loan losses:							
Balance at beginning of the period	\$ 259,949	156,266	1,713,035	9,181	18,685	218,056	2,375,172
Charge-offs	-	-	-	-	-	-	-
Recoveries	-	-	1,000	137	7,421	-	8,558
Provision for loan losses	(118,296)	(83,135)	862,593	164,375	(16,486)	(9,051)	800,000
Ending balance	\$ 141,653	73,131	2,576,628	173,693	9,620	209,005	3,183,730
Ending balance individually evaluated for impairment	\$ -	-	-	-	-	-	-
Ending balance collectively evaluated for impairment	141,653	73,131	2,576,628	173,693	9,620	209,005	3,183,730
	\$ 141,653	73,131	2,576,628	173,693	9,620	209,005	3,183,730
Loans:							
Individually evaluated for impairment	\$ -	-	-	-	-	-	-
Collectively evaluated for impairment	22,345,484	17,341,540	164,163,833	19,476,536	2,940,186	-	226,267,579
	\$ 22,345,484	17,341,540	164,163,833	19,476,536	2,940,186	-	226,267,579

TOUCHMARK BANCSHARES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements, continued

(3) Loans and Allowance for Loan Losses, continued

December 31, 2015:	Construction and Development	Real Estate - Mortgage	Commercial Real Estate	Commercial and Industrial	Other	Unallocated	Total
Allowance for loan losses:							
Balance at beginning of the period	\$ 213,782	92,527	1,129,079	130,858	1,951	90,752	1,658,949
Charge-offs	-	-	-	(132,286)	-	-	(132,286)
Recoveries	-	-	211,997	11,512	-	-	223,509
Provision for loan losses	46,167	63,739	371,959	(903)	16,734	127,304	625,000
Ending balance	<u>\$ 259,949</u>	<u>156,266</u>	<u>1,713,035</u>	<u>9,181</u>	<u>18,685</u>	<u>218,056</u>	<u>2,375,172</u>
Ending balance individually evaluated for impairment	\$ -	-	-	-	-	-	-
Ending balance collectively evaluated for impairment	<u>259,949</u>	<u>156,266</u>	<u>1,713,035</u>	<u>9,181</u>	<u>18,685</u>	<u>218,056</u>	<u>2,375,172</u>
	<u>\$ 259,949</u>	<u>156,266</u>	<u>1,713,035</u>	<u>9,181</u>	<u>18,685</u>	<u>218,056</u>	<u>2,375,172</u>
Loans:							
Individually evaluated for impairment	\$ -	-	-	-	-	-	-
Collectively evaluated for impairment	<u>21,162,817</u>	<u>20,576,071</u>	<u>96,954,649</u>	<u>14,810,099</u>	<u>2,929,251</u>	<u>-</u>	<u>156,432,887</u>
	<u>\$ 21,162,817</u>	<u>20,576,071</u>	<u>96,954,649</u>	<u>14,810,099</u>	<u>2,929,251</u>	<u>-</u>	<u>156,432,887</u>

There were no impaired loans at December 31, 2016 or 2015.

There were no past due or nonaccrual loans at December 31, 2016 or 2015.

During 2016 and 2015, the Bank did not modify any loans that would be considered troubled debt restructurings. At December 31, 2016 and 2015, the Bank did not have any outstanding recorded investment of troubled debt restructurings.

The Company utilizes a nine grade internal loan rating system for its loan portfolio as follows:

- Loans rated 1-4 (Pass) - Loans in these categories have low to average risk.
- Loans rated 5 (Internal Watch List) - These assets raise some concern due to either prior financial or collateral problems, or recent developing conditions, and thus warrant closer monitoring and review than “pass” assets.
- Loans rated 6 (Special Mention) - These assets constitute an undue and unwarranted credit risk but not to the point of justifying a substandard classification.
- Loans rated 7 (Substandard) - A substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any.
- Loans rated 8 (Doubtful) - An asset classified as doubtful has all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.
- Loans rated 9 (Loss) - Assets classified loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted.

TOUCHMARK BANCSHARES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements, continued

(3) Loans and Allowance for Loan Losses, continued

As of December 31, 2016 and 2015, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

December 31, 2016:	Pass	Internal Watch List	Special Mention	Substandard	Doubtful/ Loss	Total
Construction and Development	\$ 18,478,596	3,866,888	-	-	-	22,345,484
Real Estate – Mortgage	17,341,540	-	-	-	-	17,341,540
Commercial Real Estate	162,535,042	-	903,724	725,067	-	164,163,833
Commercial and Industrial	15,838,973	30,441	3,607,122	-	-	19,476,536
Other	2,940,186	-	-	-	-	2,940,186
	<u>\$ 217,134,337</u>	<u>3,897,329</u>	<u>4,510,846</u>	<u>725,067</u>	<u>-</u>	<u>226,267,579</u>
December 31, 2015:						
Construction and Development	\$ 18,301,149	2,861,668	-	-	-	21,162,817
Real Estate – Mortgage	20,576,071	-	-	-	-	20,576,071
Commercial Real Estate	95,135,431	153,687	1,665,531	-	-	96,954,649
Commercial and Industrial	10,939,414	33,193	3,837,492	-	-	14,810,099
Other	2,929,251	-	-	-	-	2,929,251
	<u>\$ 147,881,316</u>	<u>3,048,548</u>	<u>5,503,023</u>	<u>-</u>	<u>-</u>	<u>156,432,887</u>

During 2015, the Company purchased loans for a total purchase price of \$9,835,597. The loans had a carrying value of \$9,812,404, including accrued interest at the time of purchase. The premium is being amortized over the estimated life of the portfolio on a straight line basis as a yield adjustment. The outstanding balances of these purchased loans as of December 31, 2016 and 2015 was \$9,537,371 and \$9,718,324, respectively. These loans are included in the loan disclosures above.

(4) Premises and Equipment

Premises and equipment at December 31, 2016 and 2015, are summarized as follows:

	2016	2015
Land	\$ 400,000	400,000
Building	1,154,606	1,156,285
Furniture, fixtures and equipment	215,755	196,330
	<u>1,770,361</u>	<u>1,752,615</u>
Less: Accumulated depreciation	<u>210,096</u>	<u>241,627</u>
	<u>\$ 1,560,265</u>	<u>1,510,988</u>

Depreciation expense was approximately \$83,000 and \$95,000 for the years ended December 31, 2016 and 2015, respectively.

(5) Deposits

The aggregate amount of time deposit accounts with a minimum denomination of \$250,000 was approximately \$43,951,000 and \$16,496,000 at December 31, 2016 and 2015, respectively.

At December 31, 2016, the scheduled maturities of time deposits were as follows:

2017	\$ 73,902,128
2018	24,464,654
2019	5,247,252
2020	879,195
2021	88,151
	<u>\$ 104,581,380</u>

Time deposits listed above include \$18,452,943 and \$7,433,677 in brokered certificates of deposit at December 31, 2016 and 2015, respectively.

TOUCHMARK BANCSHARES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements, continued

(5) Deposits, continued

At December 31, 2016, the Bank had one significant customer deposit relationship with a total deposit balance of \$15,015,000. The Bank had no significant customer deposit relationships at December 31, 2015.

(6) Federal Funds Purchased

As of December 31, 2016 and 2015, the Company has lines of credit with correspondent banks for overnight borrowings of \$35,000,000 and \$31,500,000, respectively. The Company had no borrowings outstanding and \$408,000 in borrowings outstanding on these lines at December 31, 2016 and 2015, respectively. The lines of credit and outstanding balances at December 31, 2016 and 2015 were as follows:

<u>Correspondent Bank</u>	<u>2016</u>		<u>2015</u>	
	<u>Commitment</u>	<u>Balance Outstanding</u>	<u>Commitment</u>	<u>Balance Outstanding</u>
CenterState Bank	\$ 15,000,000	-	11,000,000	408,000
First National Bankers Bank	12,000,000	-	7,500,000	-
The Independent Bankers Bank	5,000,000	-	5,000,000	-
FNBB of Florida	-	-	5,000,000	-
Servis First	3,000,000	-	3,000,000	-
	<u>\$ 35,000,000</u>	<u>-</u>	<u>31,500,000</u>	<u>408,000</u>

Individually, the correspondent banks require the borrowings to be limited to a maximum of 10 to 14 consecutive days.

(7) Federal Home Loan Bank Advances

At December 31, 2016 and 2015, the Company had advances of \$19,750,000 and \$21,750,000 outstanding from the Federal Home Loan Bank of Atlanta ("FHLB"), respectively.

The following advances, which required monthly or quarterly interest payments, were outstanding at December 31, 2016:

<u>Advance Date</u>	<u>Advance</u>	<u>Interest Rate</u>	<u>Maturity</u>	<u>Rate Type</u>
03/20/2017	\$ 5,000,000	0.69%	03/20/2017	Fixed
01/25/2017	5,000,000	0.59%	01/25/2017	Fixed
08/25/2015	2,000,000	0.68%	02/27/2017	Fixed
08/25/2015	2,000,000	0.86%	08/25/2017	Fixed
03/19/2012	250,000	1.05%	03/20/2017	Principle Reducing Credit
09/04/2008	3,000,000	3.60%	09/04/2018	Convertible
09/08/2008	2,500,000	3.25%	09/10/2018	Convertible
	<u>\$ 19,750,000</u>			

TOUCHMARK BANCSHARES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements, continued

(7) Federal Home Loan Bank Advances, continued

The following advances, which required monthly or quarterly interest payments, were outstanding at December 31, 2015:

Advance Date	Advance	Interest Rate	Maturity	Rate Type
08/25/2015	\$ 2,000,000	0.43%	02/25/2016	Fixed
08/25/2015	2,000,000	0.50%	05/25/2016	Fixed
08/25/2015	2,000,000	0.55%	08/25/2016	Fixed
08/25/2015	2,000,000	0.68%	02/27/2017	Fixed
08/25/2015	2,000,000	0.86%	08/25/2017	Fixed
03/19/2012	1,250,000	1.05%	03/20/2017	Principle Reducing Credit
12/07/2015	5,000,000	0.49%	12/07/2016	Daily Rate
09/04/2008	3,000,000	3.60%	09/04/2018	Convertible
09/08/2008	2,500,000	3.25%	09/10/2018	Convertible
	<u>\$ 21,750,000</u>			

The aggregate of the advances is collateralized by the Company's FHLB stock, the Company's deposits with the FHLB, securities and a blanket floating lien on a portion of the Company's loan portfolio, portions of which can be used to cover any defaults on repayments of advances. Total amount of loans pledged as of December 31, 2016 and 2015 were approximately \$75,360,000 and \$36,001,000, respectively.

(8) Income Taxes

Income tax expense for the years ended December 31, 2016 and 2015 consisted of the following:

	2016	2015
Current	\$ 177,989	-
Deferred	(247,545)	936,936
Change in valuation allowance	203,185	-
Utilization of operating loss carryforward	1,255,371	-
	<u>\$ 1,389,000</u>	<u>936,936</u>

The Company's income tax differs from the amounts computed by applying the federal income tax statutory rates to income before income taxes. A reconciliation of the differences is as follows:

	2016	2015
Tax provision at federal statutory rate	\$ 1,304,888	925,382
State income tax	95,704	74,952
Other	(214,777)	(63,398)
Change in valuation allowance	203,185	-
	<u>\$ 1,389,000</u>	<u>936,936</u>

TOUCHMARK BANCSHARES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements, continued

(8) Income Taxes, continued

The components of deferred income taxes are as follows:

	2016	2015
Deferred income tax assets:		
Pre-opening expense	\$ 210,944	245,620
Allowance for loan losses	611,360	307,680
Net operating loss carryforwards	-	1,255,371
Capital loss carryforwards	203,185	-
Stock-based compensation	549,686	550,540
Deferred loan fees	46,282	46,282
Securities available-for-sale	97,012	4,662
Foreclosed real estate	-	89,206
Land held for sale	-	288,125
Premises and equipment	82,151	32,476
State income tax credits	168,273	120,404
Other	17,589	17,589
Gross deferred income tax assets	1,986,482	2,957,955
Less valuation allowance	(203,185)	-
Net deferred income tax asset	1,783,297	2,957,955
Deferred income tax liabilities:		
Government guaranteed loans servicing asset	252,927	188,520
Other	-	120,404
Gross deferred income tax liabilities	252,926	308,924
Total net deferred income tax assets	\$ 1,530,370	2,649,031

The future tax consequences of the differences between the financial reporting and tax basis of the Company's assets and liabilities resulted in a net deferred tax asset. A valuation allowance was established for the capital loss carryforward deferred tax assets, as the realization of these deferred tax assets is dependent on future taxable capital gain income.

The Company has approximately \$472,000 of deferred income tax assets associated with stock warrant grants that will expire in January 2018 if the warrants are not exercised, thus resulting in a tax expense charge in the statement of earnings.

(9) Related Party Transactions

The Bank conducts transactions with its directors and officers, including companies in which they have beneficial interest, in the normal course of business. It is the policy of the Bank that loan transactions with directors and officers be made on substantially the same terms as those prevailing at the time for comparable loans to other persons. The following is a summary of activity for related party loans for 2016:

Beginning balance	\$ 520,622
Loans advanced	-
Change in related party	(70,622)
Repayments	(450,000)
Ending balance	\$ -

Deposits from related parties totaled approximately \$14,550,000 and \$13,963,000 at December 31, 2016 and 2015, respectively.

TOUCHMARK BANCSHARES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements, continued

(10) Commitments and Contingencies

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. The contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

The Bank generally requires collateral or other security to support financial instruments with off-balance sheet risk.

	Approximate Contractual Amount (in thousands)	
	2016	2015
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	\$ 27,457	32,064
Standby letters of credit	\$ 139	11

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank, upon extension of credit is based on management's credit evaluation. Collateral held varies but may include unimproved and improved real estate, certificates of deposit, or personal property.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

The Company entered into an agreement to lease a location in Marietta, Georgia for a term of thirty-eight months, with the lease commencing in June 2013 and ending in July 2016. This lease contained a rental holiday for the first two months of the lease and thereafter required rental payments. The monthly rental payment was \$2,240. The terms of the lease also allowed the Company to automatically renew the lease for an additional three years. This lease was terminated in February 2015 in exchange for a payment of \$38,000.

The Company entered in a lease agreement to lease an office location in Alpharetta, Georgia for a term of fifty-four months, with the lease commencing in February 2015 and ending in July 2019. This lease contains a rental holiday for the first three months for one Suite and the first seven months for another Suite.

The minimum lease payments not including common area cost allocation under these leases are as follows:

Year ending December 31,	Minimum Lease Payments
2017	\$ 73,461
2018	75,646
2019	45,381

(10) Commitments and Contingencies, continued

Total rental expense for the years ended December 31, 2016 and 2015 was \$66,784 and \$101,458, respectively.

There is one pending claim against the Company as of December 31, 2016. The claim relates to a dispute regarding the rightful ownership of collateral seized in foreclosure by the Bank and subsequently sold. The likelihood of loss related to the claim is probable and the Company has estimated a range of loss of \$50,000 to \$150,000. As of December 31, 2016, the Company accrued \$50,000 as its estimate for potential losses related to this matter.

(11) Employee Benefits

The Company has a 401(k) plan covering all employees. Expenses of \$3,919 and \$3,773 relating to this plan were charged to operations for 2016 and 2015, respectively.

(12) Stock-based Compensation

Stock Options

During 2008, the Company adopted an Employee Incentive Stock Plan (the Stock Plan). The Stock Plan offers stock awards to key employees to encourage continued employment by facilitating their purchase of an equity interest in the Company. These awards are granted at the discretion of the Board of Directors at an exercise price determined by the Board at the grant date. Options awarded under the Stock Plan have a term of ten years from the date of grant and vest ratably over three years, unless otherwise stated in the award agreement. A total of 191,000 shares have been reserved under the Stock Plan.

The Company has 36,418 outstanding options to purchase common stock which were issued to employees of the Company. Upon issuance of options, compensation cost was recognized over the vesting period in the consolidated financial statements of the Company for all share-based payments granted, based on the grant date fair value estimated.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. Expected volatility for the period has been determined by a combination of a calculated value based on expected volatility of similar entities, and on the historical volatility of the Company's stock. The expected term of options granted is based on the short-cut method and represents the period of time that the options granted are expected to be outstanding. Expected dividends are based on dividend trends and the market price of the Company's stock price at grant. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

The Company did not record any compensation expense related to options during 2016 as all options had fully vested. The Company recognized \$2,249 compensation expense during 2015 for the vesting of options. At December 31, 2016, there was no unrecognized compensation cost related to options outstanding. At December 31, 2016, the 36,418 stock options outstanding had a weighted average exercise price of \$8.59 and a weighted average remaining contractual life of approximately 3.73 years.

Warrants

Type I (Director) warrants were awarded in recognition of certain directors' contributions to the initial capitalization of the Company. The Company awarded only 30,000 Type I warrants due to the majority of warrants issued being Type II. These warrants vest over three years.

Type II (Organizer) warrants were awarded in recognition of the financial risk undertaken by organizers in contributing seed capital and guaranteeing certain liabilities of the Company to fund organizational expenses. Warrants were issued based on the amount of funds each organizer placed at risk, which included seed capital contributed and each organizer's pro-rata share of an organizational line of credit and land loan guaranteed. The Company awarded 430,000 Type II warrants, which vested immediately upon issuance.

**(12) Stock-based Compensation, continued
Warrants, continued**

Type I and Type II warrants have an expiration term of 10 years from the anniversary date. The purchase price of each additional share under the warrant agreement is \$10 per share. Each warrant agreement has an anti-dilution clause whereby if the Company subdivides its outstanding shares of common stock into a greater number of shares, or declares and pays a stock dividend, the purchase price of each share shall be proportionately reduced, and the Company shall proportionately increase the number of shares of common stock.

Additionally, 12,500 immediately vesting warrants were issued to the organizational consultant during the first quarter of 2008. During the year ended December 31, 2010, 10,000 stock warrants were forfeited, and during the year ended December 31, 2014, 10,000 stock warrants were forfeited. At December 31, 2016 and 2015, there were 452,500 stock warrants outstanding and fully vested.

The fair value of each warrant grant is estimated on the date of grant using the Black-Scholes option-pricing model. Expected volatility for the period has been determined by a combination of a calculated value based on expected volatility of similar entities, and on the historical volatility of the Company's stock. The expected term of warrants granted is based on the short-cut method and represents the period of time that the warrants granted are expected to be outstanding. Expected dividends are based on dividend trends and the market price of the Company's stock price at grant. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. There were no warrants granted or exercised for the year ended December 31, 2016 or 2015.

The Company recorded no stock-based compensation expense for the years ended December 31, 2016 and 2015 related to these warrants.

At December 31, 2016, there was no unrecognized compensation cost related to warrants. The weighted average remaining contractual life of the warrants outstanding as of December 31, 2016 was approximately 1.08 years. At December 31, 2016, there was no aggregate intrinsic value of warrants outstanding and exercisable.

(13) Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under certain adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

In July 2013, the Federal bank regulatory agencies issued a final rule that revised their risk-based capital requirements and the method for calculating components of capital and of computing risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. The final rule applies to all depository institutions, top-tier bank holding companies with total consolidated assets of \$500 million or more and top-tier savings and loan holding companies. The rule established a new common equity

Tier 1 minimum capital requirement, increased the minimum capital ratios and assigned a higher risk weight to certain assets based on the risk associated with these assets. The final rule includes a transition period that implements the new regulations over a five year period. These changes were phased in beginning in January 2015. Management continues to evaluate this final rule and its potential impact on the Bank. Preliminary assessments indicate that the Bank will continue to exceed all regulatory capital requirements under the phased in requirements of the new rule.

TOUCHMARK BANCSHARES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements, continued

(13) Regulatory Matters, continued

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total common equity Tier 1, total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets. Management believes, as of December 31, 2016 and 2015, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2016 and 2015, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum common equity Tier 1 risk-based, total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth below. There are no conditions or events since that notification that management believes have changed the institution's category.

The Bank's actual capital amounts and ratios as of December 31, 2016 and 2015 are also presented below.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in Thousands)						
<u>December 31, 2016:</u>						
Common Equity Tier 1 (to Risk-Weighted Assets)	\$ 30,590	12.75%	\$ 10,800	4.50%	\$ 15,601	6.50%
Total Capital to Risk-Weighted Assets	\$ 33,599	14.00%	\$ 19,201	8.00%	\$ 24,001	10.00%
Tier I Capital to Risk-Weighted Assets	\$ 30,590	12.75%	\$ 14,401	6.00%	\$ 19,201	8.00%
Tier I Capital to Average Assets	\$ 30,590	12.43%	\$ 9,846	4.00%	\$ 12,308	5.00%
<u>December 31, 2015:</u>						
Common Equity Tier 1 (to Risk-Weighted Assets)	\$ 27,946	16.29%	\$ 7,721	4.50%	\$ 11,152	6.50%
Total Capital to Risk-Weighted Assets	\$ 30,107	17.55%	\$ 13,726	8.00%	\$ 17,158	10.00%
Tier I Capital to Risk-Weighted Assets	\$ 27,946	16.29%	\$ 10,295	6.00%	\$ 13,726	8.00%
Tier I Capital to Average Assets	\$ 27,946	14.32%	\$ 7,804	4.00%	\$ 9,755	5.00%

(14) Limitation on Distributions

Dividends paid by the Bank are the primary source of funds available to the Company. Banking regulations limit the amount of dividends that may be paid to the Company without prior approval of the regulatory authorities. These restrictions are based on the level of regulatory classified assets, the prior years' net earnings, and the ratio of equity capital to total assets. The Company does not have any limitation on paying dividends to its shareholders and declared a dividend of \$519,809 on November 16, 2016 for shareholders of record as of December 31, 2016. The dividend was paid on January 31, 2017.

(15) Fair Value Measurements and Disclosures

The Company utilizes fair value measurements to record fair value adjustments to certain assets. Investment securities available-for-sale are recorded at fair value on a recurring basis.

Fair Value Hierarchy

The Company groups assets at fair value in three levels, based on the markets in which the assets are traded and the reliability of the assumptions used to determine fair value. These levels are:

- Level 1 – Valuation is based upon quoted prices for identical instruments traded in active markets.
- Level 2 – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3 – Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

Following is a description of valuation methodologies used for assets which are recorded at fair value:

Investment Securities Available-for-Sale

Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange and U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter market funds. Level 2 securities include mortgage-backed securities issued by government sponsored enterprises and state, county and municipal bonds. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Loans

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and a specific allocation is established within the allowance for loan losses. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment using one of three methods, including collateral value, market value of similar debt, and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. Impaired loans in which an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is utilized or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3.

Foreclosed Real Estate

Foreclosed real estate properties are adjusted to fair value less estimated selling costs upon transfer of the loans to other real estate. Subsequently, other real estate assets are carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value is based on an observable market price, the Company records the other real estate as nonrecurring Level 2. When the fair value is based on an appraised value, or when an appraised value is not available, the Company records the other real estate asset as nonrecurring Level 3.

TOUCHMARK BANCSHARES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements, continued

(15) Fair Value Measurements and Disclosures, continued

Assets Recorded at Fair Value on a Recurring Basis

The table below presents the recorded amount of assets measured at fair value on a recurring basis as of December 31, 2016 and 2015.

<u>December 31, 2016</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
U.S. government sponsored enterprises	\$ -	1,355,628	-	1,355,628
State and municipal securities	-	2,625,196	-	2,625,196
Mortgage-backed securities	-	20,710,758	-	20,710,758
	<u>\$ -</u>	<u>24,691,582</u>	<u>-</u>	<u>24,691,582</u>
<u>December 31, 2015</u>				
U.S. government sponsored enterprises	\$ -	3,188,530	-	3,188,530
Mortgage-backed securities	-	3,290,425	-	3,290,425
Corporate securities	-	22,000,886	-	22,000,886
	<u>\$ -</u>	<u>28,479,841</u>	<u>-</u>	<u>28,479,841</u>

Assets Recorded at Fair Value on a Nonrecurring Basis

The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis are included in the table below as of December 31, 2016 and 2015.

<u>December 31, 2016</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Foreclosed real estate	\$ -	-	-	-
<u>December 31, 2015</u>				
Foreclosed real estate	\$ -	-	525,000	525,000



TOUCHMARK
B A N C S H A R E S , I N C .

Board of Directors

J.J. Shah, Chairman
Vivian A. Wong, Vice Chairman
William D. Crosby
Jorge L. Forment
Sudhirkumar C. Patel
Mukund C. Raja
Hasmukh P. Rama
Mahendra R. Shah
Meena J. Shah

Executive Officers

Jorge L. Forment
President & CEO

Kellie Pressnall
Chief Financial Officer



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